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California Courts Reject Administrative/Production Dichotomy Analysis For Exempt Insurance Employees

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The end of 2011 brought two significant labor and employment decisions that will have a large positive impact on insurance employers in California. In *Harris v. Superior Court*, 2011 WL 6823963 (Cal. Dec. 29, 2011), the California Supreme Court elaborated on the application of the administrative/production dichotomy to insurance claims adjusters, further limiting the court of appeal decisions in *Bell v. Farmers Ins. Exchange*, 87 Cal. App. 4th 805 (2001) (*Bell II*) and *Bell v. Farmers Ins. Exchange*, 115 Cal. App. 4th 715 (2004) (*Bell III*). The *Bell* cases applied the administrative/production dichotomy to conclude that claims adjusters were non-exempt production employees. In *Harris*, the Supreme Court concluded that the court of appeal erred in applying the administrative/production dichotomy rather than following the regulatory guidance applicable to workers like claims adjusters. In *Maddox v. Continential Casualty Co*., 2011 WL 6825483 (C.D. Cal. Dec. 22, 2011), the first case of its kind in California, the United States District Court for the Central District of California concluded, on summary judgment, that a commercial insurance underwriter was not a production employee and was properly classified as an exempt administrative employee. Both cases suggest that insurance employers have a strong argument that their underwriters and claims adjusters are properly classified as exempt notwithstanding the administrative/production dichotomy.

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In *Harris*, although the Supreme Court did not evaluate the exempt status of the plaintiffs, it instructed the lower courts on the proper application of the administrative exemption in Wage Order 4-2001. Specifically, it clarified that trial courts should "consider the particular facts before them and apply the language of the statutes and wage orders at issue" before resorting to other sources, such as the administrative/production dichotomy. The administrative/production dichotomy is an interpretive tool used by courts in cases evaluating the exempt status of employees under the administrative exemption. Under the dichotomy, employees whose job duties pertain to the "production" of the goods or services that the employer exists to sell or provide are typically deemed non-exempt. Conversely, employees whose job duties pertain to the operation of the business, such as human resources professionals, are considered exempt. In the *Bell* cases, the Court of Appeal applied the administrative/production dichotomy to conclude that claims adjusters for Farmers Insurance Exchange were misclassified as exempt because their job duties pertained to the processing of insurance claims, which was the service that their employer existed to provide. Farmers Insurance Exchange did not sell insurance, but existed to provide claims services to other Farmers entities.

The *Harris* plaintiffs were claims adjusters for Liberty Mutual Insurance Company. The trial court partially decertified the class as to all claims arising after October 1, 2000 on the grounds that those claims were subject to the new

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Wage Order 4-2001, which incorporated federal administrative guidance on the definition of administrative work into the regulatory elements of the exemption. Among other things, the federal regulations define as administrative the work of "white collar" employees who advise management, negotiate for, and represent the company. Notwithstanding the inclusion of this guidance, the court of appeal reversed, relying on the *Bell* cases to support its holding that, even after the amendment of the wage order, the class members were non-exempt production workers. The court of appeal ordered the lower court to deny the motion for decertification and to grant plaintiffs' motion for summary judgment.

The Supreme Court concluded that the appellate court improperly applied the *Bell* cases to the adjusters in *Harris*. The Court noted that the *Bell* cases were distinguishable because they "carefully limited their holdings to their facts, including the defendants' stipulation that the work performed by all plaintiffs was 'routine and unimportant.'" The Court of Appeal agreed with Liberty Mutual that the *Harris* class members did not perform "routine and unimportant" work, but nonetheless followed *Bell* because their claims-related work was not performed "at the level of policy and general operations." However, the *Harris* Court noted that the new Wage Order provided guidance that the Court of Appeal failed to follow, particularly in its incorporation of specified federal regulations as part of the definition of the administrative exemption. In essence, had the appellate court properly applied the wage order, it would have concluded that the question of whether the claims adjusters work was performed at the level of policy or operations was unimportant in light of the incorporated federal regulations. In short, the appellate court's approach failed "to recognize that the dichotomy is a judicially created creature of the common law which has been effectively superseded in this context by the more specific and detailed statutory and regulatory enactments." Rather than apply this outmoded construct, the Supreme Court sent a clear message that the courts should look to the regulatory guidance in interpreting the exempt status of an employee. That guidance will often lead to the conclusion that an employee is exempt.

In *Maddox*, the plaintiff was employed by CNA as a middle market underwriter in CNA's Woodland Hills, California branch office. Maddox had over 25 years experience working in the industry, including approximately 20 years of underwriting experience and more than five years working as a broker. Maddox primarily handled middle market accounts and admitted in discovery that he had a book of business in the millions of dollars. At his deposition, Maddox admitted that he was expected to evaluate risks and determine how to appropriately set premiums. Maddox's underwriting authority was defined by an authority letter and subject to various limitations, he was expected to follow underwriting guidelines, and he was required to use an automated underwriting tool called RST for documenting his accounts. Maddox also testified that he went on regular "sales" calls to the various brokerages that sell CNA policies. He testified that these calls were intended to educate brokers on CNA's products, to discuss current accounts, and to look for future business opportunities.

Maddox maintained that he was improperly classified as an exempt administrative employee and that he should have received overtime compensation and meal and rest breaks during the period he worked at CNA. He relied primarily on two theories to support his claim: first, that he was a "production" employee (and, thus, not administrative) because his duties pertained to the "production" and "sales" of insurance policies for CNA and second, that restrictions on his underwriting authority, particularly the use of RST, deprived him of the necessary discretion and independent judgment of an exempt employee. CNA moved for summary judgment contending that (1) the administrative/ production dichotomy should not be applied because Maddox's work pertained to the general business operations of CNA and CNA's customers and (2) that Maddox's work inherently entailed the exercise of discretion and independent judgment, even if his discretion was not limitless.

First, the court concluded that Maddox's job duties pertained to general business operations because Maddox "performed work of substantial importance which was directly related to the management policies or general business operations of CNA and its customers." Importantly, Maddox's "duties included assessing a myriad of insurance risks presented to the company, determining whether those risks were acceptable to CNA, and if so, making a judgment as to how to price those risks profitably." Maddox was also "responsible for developing new business and nurturing his existing relationships with various brokers and agents that made up his book of business . . . ." Based on these duties, the court found that it could not "be seriously disputed" that Maddox's duties pertained to general business operations. Consequently, the court rejected Maddox's contention that he was merely a production worker.

Second, the court concluded that Maddox "customarily and regularly exercised broad discretion and independent judgment with respect to matters of great significance and with potentially significant consequences to CNA." The court focused on the fact that Maddox's underwriting authority gave him plenary discretion to make underwriting decisions within the limits of his authority. The court rejected any notion that the guidelines Maddox was required to follow precluded him from exercising legally sufficient discretion. The court also rejected the notion that Maddox's use of RST precluded him from exercising discretion and independent judgment, particularly because CNA expressly instructed underwriters that they were not to use RST's pricing tool as the sole determining factor in underwriting their accounts.

Maddox and *Harris* both undermine the applicability of the administrative/ production dichotomy, at least with respect to employees in "white collar" positions, such as underwriters and claims adjusters. These decisions confirm that such employees cannot easily be pigeonholed into the administrative/ production dichotomy. Further, the *Harris* decision clearly limits the *Bell* cases to their facts and calls into question whether the *Bell* cases have any application to claims arising after the October 2000 adoption of Wage Order 4-2001. These cases are very good news for insurance employers in California.